

# Macquarie Income Opportunities Fund

Monthly report – 30 September 2022

## Investment objective

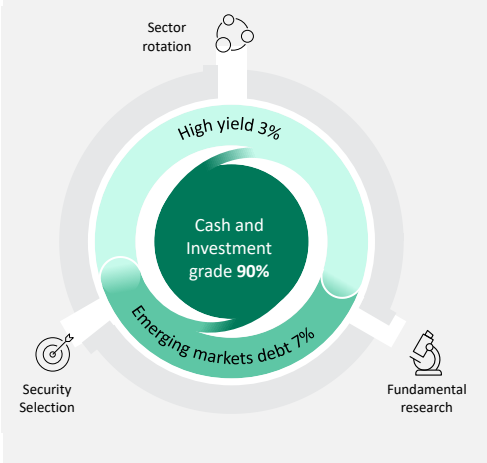
Aims to outperform the Bloomberg AusBond Bank Bill Index over the medium term (before fees). It aims to provide higher income returns than traditional cash investments at all stages of interest rate and economic cycles.

## Key information

### Fund details

APIR code	MAQ0277AU
Inception date	18 September 2003
Fund size	\$3,560.3m
Distribution frequency	Monthly
Management fee*	0.492% pa
Minimum investment (Direct)	\$20,000
Unit prices and spreads	<a href="https://macquarie.com.au/unit_prices">macquarie.com.au/unit_prices</a>

\*Read the Product Disclosure Statement for more details on fees and costs.



## Fund performance to 30 September 2022

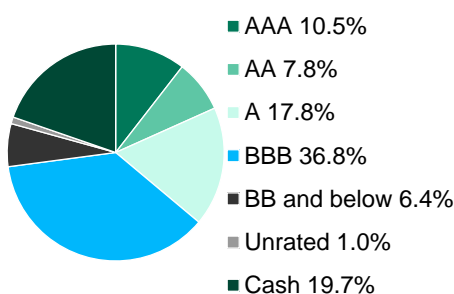
	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)
<b>1 month (%)</b>	-1.39	-1.43	0.15	-1.58
<b>3 months (%)</b>	-0.35	-0.48	0.42	-0.90
<b>1 year (%)</b>	-5.56	-6.03	0.52	-6.55
<b>3 years (% pa)</b>	-0.52	-1.01	0.38	-1.39
<b>5 years (% pa)</b>	1.07	0.57	0.95	-0.38
<b>10 years (% pa)</b>	2.80	2.30	1.68	0.62
<b>Since inception (% pa)</b>	4.50	3.99	3.46	0.53

Past performance is not a reliable indicator of future performance.

Total returns are calculated based on changes in net asset values and assumes the reinvestment of distributions.

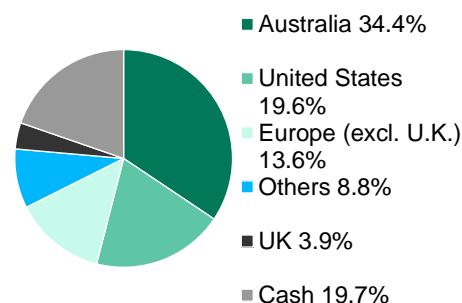
Total net Fund returns are quoted after the deduction of fees and expenses. Due to individual circumstances, your net returns may differ from the net returns quoted above.

## Credit profile breakdown



Average credit rating: A-  
BB and below include direct holdings and residual exposure to issuers held through our investment grade and emerging markets allocation.

## Region breakdown



## Asset allocation

Sector	Market value %
Investment grade corporates <sup>^</sup>	51.6
Investment grade government*	0.2
Asset-backed securities	18.6
High yield corporates <sup>^</sup>	3.1
Emerging market corporate	4.6
Emerging market government <sup>^</sup>	2.2
Cash and equivalents	19.7

Asset-backed securities include but are not limited to residential mortgage backed securities, bank loans and other credit related securities.

<sup>^</sup>Fund holds (0.0%) in investment grade, (0.9%) in high yield and (0.0%) in emerging markets credit hedges as synthetic cash (reduction in percentage of physical cash exposure).

## Fund statistics

Credit spread duration	2.3 years
Interest rate duration	2.5 years
Standard deviation <sup>^</sup>	2.0% pa
Yield to maturity*	5.7% pa
Cash	19.7%
Cash exposure through credit hedges <sup>+</sup>	0.9%

<sup>^</sup>Statistical measure of variance of Fund's post-fee monthly returns from its average post-fee return since inception used as gauge of volatility.

\*Pre-fee returns Fund would earn over next year based on current market conditions if there were no changes to interest rates or holdings of Fund. It is not an actual or estimated return.

<sup>+</sup>Credit hedges swap the return for underlying credit index for cash.

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## Fund highlights

The Fund underperformed the benchmark for September, with a broad acceleration of previous themes: inflation, aggressive tightening from central banks, and geopolitics; now joined by financial stability concerns as UK government bond markets suffered significant losses and illiquidity, and global currencies fell sharply. Duration exposures were the largest single driver of the performance for the month, with developed market bonds continuing their recent sharp sell-off: USD and AUD-denominated bond positions were the largest detractors. Credit exposures also detracted, particularly in the final days of the month as market sentiment deteriorated. The largest single sector detractor was investment grade credit, reflecting the size in the portfolio and additions though the year to this sector, given increasingly attractive spreads. High yield was also a detractor, though to a smaller degree. Among individual performers, US banks were a detractor (such as Bank of America, Morgan Stanley and JP Morgan), with spreads reaching levels not seen in the last 10 years (outside of the brief COVID window): we see these names as offering value given the strong fundamentals and are comfortable with the position.

The Fund's positioning remains with significant liquidity (with cash and short-dated investment grade totalling over 40% of holdings), offering meaningful opportunities to begin to look at opportunities in a sharply higher yield environment. During the month, the Fund trimmed a small number of more cyclically exposed sectors, such as auto parts and travel – we view the outlook for markets as remaining volatile and have previously added higher quality investment grade credit during periods of spread weakness. The Fund also further trimmed its recent addition of Australian bank subordinated bonds, after strong performance in these recent new issues.

## Market overview

Central banks around the world maintained aggressive rate hiking cycles over the month and signalled that there is more to come. This is the fastest rate hiking cycle since the early 1980s and the magnitude is rising, with 75 basis point moves delivered by the US, European, and Canadian central banks, and 50 basis point moves in the UK and Australia. These actions and statements of intent to tame inflation continue to pull bond yields higher. Risk markets are waking up to the prospect that the unintended consequence of central banks' efforts to bring inflation under control could be a recession, with major equity indices falling by 5-8% in the month. Credit spreads too are widening, with US investment grade spreads 17 basis points wider (European investment grade was 23 basis points wider) in the month, but as would be expected sub-investment grade underperformed, widening 68 basis points while emerging market sovereign spreads were 58 basis points wider.

If this was not enough for markets to contend, the new UK Prime Minister and Chancellor unveiled expected fiscal support measures to contain the impact of higher energy prices on households and businesses but tagged on significant unfunded tax cuts that are biased to benefit high income earners. The UK government bond market exploded higher, particularly the long end – which rippled around global markets and eventually prompted the Bank of England (BoE) to intervene and buy bonds, reversing its intent to begin unwinding its balance sheet. The Japanese yen meanwhile continued to decline against the US dollar, despite efforts by the Bank of Japan to stem the tide.

Markets were weak in September, with familiar themes of inflation and geopolitics, as well as accelerated US Treasury market volatility. Those themes were joined by sharp selloffs in non-USD bond markets, which drove broad asset market selling and illiquidity the culminated in the BoE intervening to buy long end bonds to restore stability.

United States investment grades (IG) spreads finished the month 19 basis points wider, to 159 basis points, which much of the move occurring in the final days of the month. Amongst sectors, financials performed weakest, led by United Kingdom banks (reflecting the turmoil in that economy and government bond market), though United States banks were also affected: JPM senior 10-year bonds, for example, now trade with a 220 basis points spread, wide of any period in the last 10 years (outside the brief COVID market shock). Across the quality spectrum, results were unusual: BBB (the lowest investment grade rating) outperformed single-A, but CCC bonds (the lowest rating rank in high yield before default) underperformed the entire market, suggesting credit weakness is both a combination of solvency concerns for weak companies, as well as poor liquidity in all markets.

Reflecting the weak backdrop, new issuance volumes were well below expectations – September is generally a very heavy month as the Northern hemisphere returns from Summer. In total, just under US\$80 billion was issued in the IG market, around half of initial estimates, and only a few \$billion total in high yield: with several 'hung' M&A deals either pricing with very large discounts or withdrawing from sale entirely: all indicators of the weak tone in the market. Notable issuers in IG included T-Mobile, one of the largest mobile operators in the market, which issued its first 10, 30 and 40 year bonds after an upgrade to full investment grade earlier this year.

European credit underperformed global peers closing 23 basis points wider to new wides of 225 basis points. The weakness was broad based but cyclicals underperformed such as higher beta chemical names +50-80 basis points and lower rated IG airlines such as Easyjet almost 100 basis points wider this month. Issuance totalled €44billion which was heavily skewed to the first half of the month with more stable spreads. High yield (HY) supply remains very light but the names that did come highlight the dynamics of the market re-pricing, Verisure (B/B1 consumer services) paid a 9.25% coupon to refinance their upcoming 3.5% 2023 maturity.

There was significant volatility GBP credit following the United Kingdom government fiscal expansion as long end gilts went from 3% to north of 5% before the BoE had to intervene, GBP corporate spreads closed 29 basis points wider. There was forced selling of GBP credit even in the highest quality securitised deals as investors sought cash to fund collateral requirements. Valuations in credit continue to improve although the outlook remains challenged ahead of corporate earnings with elevated inflation and central bank tightening.

Australian credit widened over the month albeit to a lesser extent relative to the offshore markets. IG spreads finished the month +15 basis points on option-adjusted spread basis though this was partly driven by swap spread widening. The credit curve steepened slightly with

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long-end generically flat to 10 basis points wider. Senior financials underperformed with spreads drifting +3 basis points to +8 basis points with the latest 5-year CBA senior bond ending the month at 100 basis points. In the financial subordinated space, spreads on the new 10NC5 bonds tightened as much as 12 basis points mid-month before giving back most of the gains in the last week of September to be only 2 basis points tighter. While there were no significant spread moves in the structured space, the market did receive several Bid-Wanted-In-Competition from a range of United Kingdom investors to cover margin calls on the back of the volatility seen in the United Kingdom rates market. In the primary market, the IG market saw slightly less than \$A6 billion of issuance all in financials and it is worth noting that this included a number of private placements via reverse enquiries. In the structured space, \$A3.6 billion was priced across height deals and a further ~\$A3 billion has already been mandated for early October.

### Outlook

Over the past two years, our analysis has determined that the economic environment was being largely defined firstly by the pandemic shock and then later by the energy price shock resulting from the war in Ukraine. However, the latest analysis at the Macquarie Fixed Income team's September Strategic Forum pointed to the outlook being increasingly defined by the aggressive stance by central banks to tame inflation.

Measures of the supply side point to continued gradual recovery, despite various setbacks, although there is still a lot of repairs to get back to pre-pandemic levels and the energy outlook is more uncertain due to geopolitics. The demand side is slowing, but the picture is varied across countries, with Europe and the UK the hardest hit and the US proving relatively resilient. The rate hiking cycle underway will impact demand, and central bank overtightening is expected to mean that demand destruction will become the dominant driver of the economic outlook in coming quarters. Unfortunately, inflation is not providing central banks with any reason to hold back, despite the hopes of asset markets for a reprieve and despite the knowledge that demand will be hit. Recession is increasingly becoming the consensus expectation for 2023.

Current stagflation and the prospect of recession in 2023 implies that high volatility will persist across asset markets. Inflation has pulled bond yields higher than expected, but we see value returning, with bonds offering an attractive entry point and strong protection levels for multi-asset strategies. Credit fundamentals remain strong, but the outlook suggests that these will come under pressure, particularly if a hard landing manifests.

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**For more information speak to your financial adviser, call us on 1800 814 523, email [mam.clientservice@macquarie.com](mailto:mam.clientservice@macquarie.com) or visit [macquarieim.com](http://macquarieim.com)**

### Important information

Macquarie Investment Management Australia Limited ABN 55 092 552 611 AFSL Licence 238321 is the issuer of units in, and responsible entity of the Fund. Macquarie Investment Management Global Limited ABN 90 086 159 060 AFSL 237843 is the investment manager of the Fund.

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